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SUBJECT: DUTCH 2007 BUDGET: LET THE GOOD TIMES ROLL

REF: THE HAGUE 2140

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ACCORDINGLY.

11. (SBU) SUMMARY. The Netherlands' center-right governing coalition has presented a draft 2007 budget that includes a surplus for the first time in five years, new tax breaks, and increased spending on national security. Unveiled just two months before parliamentary elections on November 22, the ruling coalition hopes that these measures together with an upswing in the economy will win over Dutch voters. Meanwhile, official advisory bodies worry that the draft budget fails to address possible future challenges related to an aging population, global competition, and energy security. END SUMMARY

2007 BUDGET - SMALL SURPLUS, TAX CUTS

12. (U) Dutch Finance Minister Gerrit Zalm presented to Parliament on September 19 a draft 2007 national budget. With estimated revenues totaling 157.5 billion euros (\$200 billion) and government expenditures at 156.8 billion euros (\$199 billion), the budget forecasts for the first time in five years a small surplus of 887 million euros (\$1.1 billion or 0.2 percent of GDP). The draft budget also assumes a projected 3.0 percent GDP growth in 2007 (slightly lower than the 3.25 percent growth forecasted for 2006); a slight increase in inflation to 1.5 percent (up from an anticipated 1.25 percent in 2006); and unemployment decreasing further from an anticipated 5.5 percent in 2006, down to 4.5 percent in 2007.

13. (U) Other key elements of the budget include a real cut in corporate taxes worth about 500 million euros (\$625 million) and reductions in consumer energy taxes and unemployment premiums worth about one billion euros (\$1.25 billion). These measures will largely be financed out of a hard-fought discount on the Dutch contribution to the EU worth about 1 billion euros (\$1.25 billion). While the corporate tax rate will fall to 25.5 percent in 2007 from 29.6 percent in 2006 under this plan, the overall corporate

tax burden for most companies operating in the Netherlands, and especially for medium-sized firms, is not expected to change due to a widening of the tax base.

MORE SPENDING ON DEFENSE AND COUNTERTERRORISM

¶4. (U) Under the draft budget, national defense spending will increase in 2007 to 7.9 billion euros (\$10 billion dollars), 100 million euros (\$127 million) more than originally planned. These additional funds will help support the deployment in 2007 of over 5,000 troops to missions in Afghanistan, Bosnia, Africa, and possibly Lebanon. The GONL also plans to create a separate fund of 195 million euros (\$247 million dollars) to finance crisis management operations. The GONL announced on September 29 its intention to sign before November 22 an MOU extending Dutch participation in the development and production of the Joint Strike Fighter (reported reftel). A decision on procurement will be left to the next cabinet. Other funded programs include the completion of a multi-year project to reorganize Dutch armed forces and Ministry of Defense participation in the C17 transport project.

¶5. (U) The draft budget also earmarks 33 million euros (\$42 million) for Ministry of Justice (MOJ) counterterrorism efforts in 2007, with some 30 million euros (\$38 million) going directly to the National Coordinator for Counterterrorism (NCTb). Over the next few years, the MOJ is expected to spend an additional 31 million euros (\$39 million) to improve camera surveillance of railways and airports. (These amounts exclude funds spent by ministries of Defense and Interior on counterterrorism efforts.)

CASHING IN ON GOOD TIMES AHEAD OF ELECTIONS

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¶6. (SBU) With parliamentary elections only two months away, the 2007 budget marks the final part of a four-year strategy by the government to first implement structural reforms, followed by the presentation of popular policies in the final budget. Unlike in previous years, the final budget figures and the anticipated surplus were only known by Minister Zalm and his senior staff and were not leaked to the press or other members of the government ahead of the September 19 presentation to parliament. Zalm undoubtedly wanted the positive budget figures to reflect well on his party, the VVD (conservative Liberals), ahead of November 22 parliamentary elections. The current ruling CDA (Christian Democrats) and VVD coalition hopes that proposed tax breaks, increased spending on national security, and a strong performance by the economy will work in its favor in the upcoming elections.

¶7. (U) This strategy has been supported by continued growth in the Dutch economy, up by 2.8 percent in the second quarter of 2007. While this figure is slightly less than the 2.9 percent recorded in the first quarter, it is still stronger than the eurozone average. Sources such as Eurostat report current Dutch unemployment at 3.9 percent, the lowest rate within the EU and twice as low as the 8 percent EU-25 average. The harmonized European inflation figure (HICP) for the Netherlands was 1.9 percent in August, lower than the eurozone average of 2.3 percent. For the first time since 2002, Dutch citizens are also expected to experience a real increase in purchasing power.

BUT ECONOMIC CHALLENGES REMAIN

¶8. (U) Nonetheless, the draft budget is not without its critics. Taking a less rosy view than the governing coalition, the Council of State, the highest government advisory body and administrative court in the Netherlands,

has advised that the projected budget surplus should be greater given the current turnaround in the economy. It argues that a small surplus leaves the future government with too little resources to address issues related to an aging population, global competition, and energy security. Similarly, the Netherlands Bureau for Economic Policy Analysis (CPB) warns that a projected surplus based on the current upswing in the economy and an increase in natural gas revenues may not suffice to counter the negative effects on the structural budget of increased spending and lower taxes. The CPB also argues that the proposed corporate tax cuts will not lower the corporate tax burden until 2014, while actually increasing it by 1 billion euros (\$1.3 billion dollars) in the coming year.

COMMENT: VOTING WITH THEIR POCKET BOOKS

19. (SBU) The state of the Dutch economy is clearly playing a major role in the lead-up to parliamentary elections. With the economy on an upswing and more money to spend, the ruling CDA/VVD coalition certainly hopes this good economic news will swing significant numbers of Dutch voters in their direction on November 22. So far, the strategy seems to be working -- recent polls show the CDA eroding the PvdA's (social Liberals) once-strong lead, and most experts agree that another CDA-VVD coalition government emerging from the elections is now a real possibility.

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